DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

February 22, 1990

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 89/74

The following corrections have been made in the final minutes of EBM/89/74 (6/14/89):

Page 2: Add item "8. Venezuela - Technical Assistance...Page 44"

An incorrect page 16 of EBM/89/79 (6/21/89) was inadvertently placed in EBM/89/74 (6/14/89) and should be replaced with the new page 16.

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/74

10:00 a.m., June 14, 1989

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
F. Cassell	
Dai Q.	Zhang Z.
	C. S. Warner
	J. Prader
E. T. El Kogali	
	F. E. R. Alfiler, Temporary
	R. J. Lombardo
	M. A. Fernández Ordóñez
R. Filosa	
M. Finaish	M. B. Chatah, Temporary
M. R. Ghasimi	O. Kabbaj
G. Grosche	
	Hon C.-W., Temporary
	L. E. N. Fernando
	A. Vasudevan, Temporary
	J. R. N. Almeida, Temporary
	G. Bindley-Taylor, Temporary
	D. McCormack
	C. V. Santos
	I. A. Al-Assaf
J. Ovi	M. Fogelholm
H. Ploix	
	G. P. J. Hogeweg
	S. Yoshikuni

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

Also Present
African Department: E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director; C. P. Andrade, C. V. Callender, I. S. McCarthy. European Department: J. J. Hauvonen. Exchange and Trade Relations Department: H. M. Flickenschild. External Relations Department: N. Worth. Fiscal Affairs Department: T. M. Ter-Minassian, Deputy Director; I. Coelho. Legal Department: R. H. Munzberg, Deputy General Counsel; H. Elizalde, A. O. Liuksila. Secretary's Department: K. S. Friedman. Treasurer's Department: F. G. Laske, Treasurer; D. Williams, Deputy Treasurer; M. N. Bhuiyan, S. I. Fawzi, D. Gupta, R. B. Hicks, B. E. Keuppens, C. P. McCoy, J. A. McLaughlin, A. F. Moustapha, A. Salehizadeh, T. M. Tran, T. Voulgaris, G. Wittich, B. B. Zavoico. Bureau of Statistics: D. J. Scheuer. Office of the Managing Director: R. Noë, Internal Auditor. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. Eran, J.-P. Menda, P. O. Montórfano, D. C. Templeman, R. Wenzel. Assistants to Executive Directors: H. Codrington, B. A. Christiansen. E. C. Demaestri, S. K. Fayyad, J. Gold, S. Guribye, M. E. Hansen, M. Hepp, J. Heywood, M. E. F. Jones, V. K. Malhotra, W. K. Parmena, S. Rouai, C. Schioppa, J.-P. Schoder, G. Serre.

Account, than the 5 percent of reserves that had been agreed during the review of the burden sharing arrangements (EBM/89/46, 4/26/89). He did not find that idea attractive, however. The Special Contingent Account was very different from the Fund's general reserves, both in its financing and in the broad criteria for its refundability. A shift at the margin from the net income target to the Special Contingent Account would not only affect the rate of growth of reserves in the future, it would also amount to a back door method of increasing burden sharing. He strongly preferred increasing the amount in the Special Contingent Account by 5 percent of reserves, therefore, as previously agreed, and setting the net income target for the year at SDR 85.5 million.

He shared the concerns of those Directors who had argued that the current system for determining the rate of charge could lead to undesirably sharp changes in the rate from one period to the next, Mr. Cassell stated. He had experienced some problems with the current system as well, and in particular, with the asymmetry that existed with respect to retrospective adjustments to the rate of charge. The fact that it was not possible, under the current system, to reduce retrospectively the rate of charge had of course increased the risk of shortfalls in the net income target, and had led his chair and others to advocate a very cautious approach to the setting of the rate of charge.

Of the alternative arrangements for determining the rate of charge that had been put forward by the staff, he found Method I--the determination of the rate of charge at the beginning of the financial year, with adjustments to it at the beginning of subsequent quarters on the basis of revised income estimates--to be the least attractive, Mr. Cassell commented. That option might still lead to fairly significant shortfalls in net income under certain circumstances. Moreover, its main apparent advantage--the fact that the basic rate of charge would be known to borrowers at the beginning of the quarter--might not have much significance in practice, since, under the burden sharing arrangements, the actual rate of charge payable by members would reflect an ex post adjustment at the end of each quarter so as to cover deferred income during that quarter. The extent of that adjustment, and hence the overall rate of charge, would not be known in advance. That being said, he found himself drawn more to the other two methods the staff had put forward. He had a marginal preference for Method III--a retrospective adjustment of the rate of charge shortly after the end of each quarter in the light of actual developments. That method should ensure that the net income target would be attained each year. However, as the staff argued, there might be little difference in practice between Method II and Method III, and he would have no difficulty with linking the rate of charge to the SDR interest rate--Method II--if that commanded broader support in the Board.

The staff paper considered the question of whether there should be a cap on the rate of charge, Mr. Cassell concluded. He understood the concerns of some Directors about the current high level of the rate of charge. Like those Directors, he firmly believed that the terms on which the Fund, as a cooperative institution, made its resources available to members should not be wholly dictated by the market. However, it was important not to confuse a high rate of charge with nonconcessionality. The Fund's current rate of charge was certainly below the rate at which debtor members would be able to borrow resources from the markets. It also remained below the World Bank's lending rate. In those circumstances, and given the continuing problem of arrears, he firmly endorsed the staff's remark that it would not be prudent to reduce the target amount of net income at present in order to accommodate some limit on the rate of charge.

Mr. Fernández Ordóñez made the following statement:

I would like to express my appreciation to the staff for providing some options for calculating the rate of charge, in response to the suggestion we made last December. We have all the information we need to adopt a decision.

I strongly support the staff proposal, namely, Method II, in which the rate of charge is set at the beginning of the financial year as a proportion of the SDR interest rate. This method has important advantages for the work of the Board, for better protecting the financial position of the Fund, and for the debtor countries.

First, members will not have to face dramatic changes in the rate of charge, which is a negative element from the point of view of the Board's work. With the new system, the changes, if needed, will be changes only of a few basis points. The Board will therefore spend less time complaining about changes in the market--which is useless anyway--and will be able to focus more on what is in its own hands, namely, the determination of the net income target. With the present method, the Board is forced to approve drastic changes in the rate of charge. It has been obliged in the past to double the changes in the SDR interest rate. In December, when the SDR interest rate increased by 69 basis points, the interest rate charged to debtors had to be increased by more than 160 basis points. It is important that the Board does not have to face these kinds of dramatic decisions when, in fact, they are just the consequence of movements in the market.

The present method could also be dangerous. When interest rates increase, there is always the temptation not to increase the rate of charge, and this could weaken the Fund's financial position. But, in the case of a decreasing SDR interest rate, it would be a temptation not to follow this trend, and to increase the Fund's reserves above the target that was adopted at the beginning of the year. Thus, the new method has advantages not only from the point of view of the Fund's financial strength, but also of the debtor countries.